iRobot First-Quarter 2018 Conference Call

Operator:

Good day everyone and welcome to the iRobot first-quarter financial results conference call. This call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to Elise Caffrey of iRobot Investor Relations. Please go ahead.

Elise:

Thank you and good morning. Before I introduce the iRobot management team, I would like to note that statements made on today's call that are not based on historical information are forward-looking statements made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995.

This conference call may contain express or implied forward-looking statements relating to the company's financial results, operations and performance for fiscal 2018 and each quarter thereof; the growth, performance, revenue impact and prospects of our business, including in the United States, EMEA, Japan and China; our expectations regarding profitability; our expectations regarding revenue, the rate of revenue growth, gross margins, operating income, operating expenses, operating margin, sales & marketing expenses, research and development expenses, general and administrative expenses, restructuring charges, stock compensation expenses, depreciation and amortization expenses, inventory, tax rate, earnings per share and cash; seasonality and predictability of our business; our expectations regarding currency exchange rates; our expectations regarding our ability to penetrate further the robotic vacuum cleaner and wet floor care markets; the impact of our continued investments in sales & marketing and in R&D, technology and innovation; the impact of our efforts to increase consistency and awareness of our brand and to protect our IP; domestic and international demand for robotic vacuum cleaners (RVC) and our RVC products; demand for and revenue and revenue growth opportunities associated with our wet floor care products, including our

Braava family of floor mopping robots; our intent to make, and the impact on our financial results of, strategic investments; our intent regarding the introduction and delivery of new products, applications and product capabilities and functionality, and the timing and impact thereof; the impact on our financial results of our acquisitions of our European and Japanese distributors; our market share and opportunity; and business conditions**.**

These statements are neither promises nor guarantees, but are subject to a variety of risks and uncertainties, many of which are beyond our control, which could cause actual results to differ materially from those contemplated in the forward-looking statements. In particular, the risks and uncertainties include those contained in our public filings with the Securities and Exchange Commission. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. iRobot undertakes no obligation to update or revise these forward-looking statements, whether as a result of new information, future events or circumstances or otherwise.

During this conference call, we may also disclose non-GAAP financial measures as defined by SEC Regulation G, including Adjusted EBITDA, which we define as earnings before interest, taxes, depreciation, amortization, merger, acquisition and divestiture (income) expense, restructuring expense, net intellectual property litigation (income) expense, and non-cash stock compensation expense. A reconciliation between Adjusted EBITDA and net income – the GAAP measure most directly comparable to Adjusted EBITDA is provided in the financial tables at the end of the first-quarter 2018 earnings press release issued last evening, which is available on our website http://investor.irobot.com/news-releases?field_nir_news_date_value%5Bmin%5D=2018#views-exposed-form-widget-news-widget-news-ul.

A live audio broadcast of this conference call is also available on the Investor Relations page of our website and an archived version of the broadcast will be available on the same Web page following the call. In addition, a replay of this conference call will be available through May 1, 2018 and can be accessed by dialing **404-537-3406**, access code **7776299.**

On today's call, iRobot Chairman & CEO Colin Angle will review the company's operations and achievements for the first quarter of 2018 and Alison Dean, Chief Financial Officer, will review our financial results for the first quarter of 2018. Colin and Alison will also provide our business and financial expectations for fiscal 2018. Then we'll open the call for questions.

At this point I'll turn the call over to Colin Angle.

Colin:

Good morning and thank you for joining us.

We are off to the strong start we expected in 2018. First quarter revenue grew **29%** over Q1 2017, driven by growth across all major regions. Robust replenishment, following strong Q4 2017 holiday sell-through, and shipments to support Q2 holidays in the United States, drove domestic revenue growth of **26%** over last year. EMEA and Japan also saw significant year-over-year growth of **47%** and **38%,** respectively in part driven by the revenue uplift from the acquisitions, neither of which we had in Q1 2017.

On our February earnings call, the 2018 commitments we made were to:

- Drive revenue growth of **19% - 22%** through deeper household penetration of Roomba® globally;
- Deliver double-digit revenue growth in the U.S. and overseas;
- Expand gross margin due to distributor acquisitions;
- Drive greater global iRobot brand consistency and awareness;
- Continue investment in innovation to extend our technology and product leadership in the category; and,
- Deliver several new products in the second-half of the year.

With one quarter under our belt, we are on track across the board.

- Revenue increased **29%** in Q1 2018 over Q1 2017 with double-digit revenue growth in all major regions;
- Gross margin for the first quarter this year was **53%,** up from **52%** for the first quarter of 2017;
- Our acquisitions have enabled more consistent global control of our brand and execution of our marketing programs; and,
- Our investments in R&D continue as planned and our new product introductions are on schedule for launch in the second half.

Given our Q1 results and our outlook for the rest of the year, we are reaffirming our 2018 full-year revenue and operating income expectations and increasing our full-year expectations for earnings per share to reflect a **$0.05** favorable impact, from stock compensation windfall, that we recorded in the first quarter. We anticipate full-year 2018 revenue of **1.05** to **1.08** billion dollars, which is year-over-year growth of **19 – 22%,** operating income of **86** to **96** million dollars, and EPS of **$2.15** to **$2.40**.

Now I'll take you through some of the highlights of Q1 2018, and our business expectations for the rest of the year.

First, I'd like to highlight our successful efforts in developing meaningful revenue diversification through our Braava family of floor mopping robots. In talking to investors since our last call, I sensed some confusion about the performance of the category. Our plan for growing Braava is built upon the success of our Roomba marketing efforts over the last few years. We see a tremendous opportunity to drive adoption of Braava products through campaigns targeted at our millions of Roomba customers and have started to see the payoff in the U.S., the only region where we have done TV advertising and where we have made the majority of awareness investment, and to a lesser degree in Europe. As we discussed on last quarter's call, in Q4 2017 we launched our first ever Braava national television advertising in the U.S. and category revenue grew **65%** in 2017 over full-year 2016. In Q1 2018, the momentum generated by the campaign continued driving U.S. revenue growth of nearly **35%** over the first quarter last year, and we expect that our additional 2018 investments will generate full-year domestic Braava revenue growth at a rate greater than the company's overall 2018 revenue growth rate.

We believe there is a meaningful global growth opportunity for the floor mopping category that is predicated on improving Braava products' positioning and better articulating the value propositions. Promotions of this category have been fragmented and uneven across the globe under our distributor model, however, where **WE** have made advertising investments, as we did last year in the U.S., demand has been very strong. Therefore, additional advertising investment in Braava, under our direction, is critical. Lack of awareness and articulation of the products' value propositions are the hurdles we must overcome to drive this growth.

One of the components of our 2018 incremental sales & marketing investment, we discussed in February, is executing Braava marketing programs for all major markets. In the U.S., we have a strong digital marketing and social media campaign planned for Q2 to support Mother's Day, and in Q4 we will run a national TV campaign similar to the one we ran last year at the same time. In addition, there is a TV campaign planned for Japan later this year.

We began our marketing campaigns for Roomba first in the U.S. where we had been selling the product the longest and had the strongest brand recognition and market share. Since then, we have selectively expanded them into overseas markets with positive results. We are confident that putting additional investment to support Braava promotions globally will help drive awareness and adoption of the category as it has for Roomba.

Now turning to our first-quarter performance by region, we delivered **26%** year-over-year revenue growth in the U.S. while international revenue increased **32%**. In the US, sales remained robust coming off the tremendous holiday season. In EMEA, revenue grew **47**% where we saw strong demand while also benefiting from the revenue uplift associated with sales in the EMEA countries where we now sell direct. Japan revenue grew **38%** in Q1 over 2017, also benefiting from the revenue uplift from the acquisition. Note that in Q2, we anniversary the acquisition of SODC, so we will not see this rate of year-over-year quarterly revenue growth in the remaining quarters. We still expect full-year 2018 growth of **25 – 30%** in EMEA and mid-teen growth in Japan.

On our last call, I talked quite a bit about the increasingly competitive landscape driven by traditional consumer appliance companies trying to gain traction in the category. Since then, several premium European brands have launched products and others have announced but not launched. The Chinese competitors that entered the U.S. market last year through online channels have not gotten traction in U.S. retail stores, but we anticipate that a few retailers will test some of the Chinese products in stores this year. Some of these products have shown up in some select European markets.

We continue to believe that a multi-pronged approach to maintaining unambiguous brand and product leadership in robotic vacuum cleaners is the right one. It remains critical to make focused investments to drive this including:

- R&D to continue to deliver differentiated products that further strengthen our position;
- Sales & Marketing, both in the U.S. and overseas, to continue to drive awareness and articulate the difference between our products and others'; and
- Initiatives to validate the strength of our IP and widen our competitive moat while dispelling false claims by competitors.

In summary, we are off to an excellent start in 2018 and on track to meet the full-year expectations we provided in February.

I will now turn the call over to Alison to review our first quarter results in more detail.

Alison

Our first quarter revenue and operating income were in line with our expectations, and EPS was slightly ahead due to the stock compensation windfall that Colin mentioned. Quarterly revenue of **$217** million increased **29%** from Q1 last year. Operating income for Q1 was **$25** million compared with **$22** million for Q1 2017. EPS was **$0.71** for the quarter, compared with **$0.58** in Q1 2017**.** Quarterly EPS included **$0.05** of tax benefit relating to stock compensation accounting compared with a **$0.06** tax benefit in Q1 2017. Keep in mind that our Q1 2017 effective tax rate, before discrete items, was **31%** prior to the new tax law change, while our Q1 2018 rate, before discrete items, was **27%,** in line with our expectations, following the change. Tax rate for Q1 2018 inclusive of discrete items was **21%** compared with Q1 2017 tax rate of **24%** inclusive of discrete items.

Revenue growth of **29%** for Q1, included domestic growth of **26%**, EMEA growth of **47%** and Japan growth of **38%,** driven by stronger demand and ASP improvements which for EMEA and Japan were primarily driven by the ASP uplift from the acquisitions, and the favorable impact of Euro and YEN exchange rates and our hedging contracts. We continue to be very pleased with our two acquisitions and their performance to date.

Gross margin was **53%** for the first quarter, compared with **52%** in Q1 2017. The **150** basis point increase was due to higher average ASPs and COGS improvements, offset by the Robopolis intangible asset amortization. Keep in mind that quarterly gross margin can fluctuate widely based on mix, seasonality and promotional activity among other things. We expect Q1 will be the highest gross margin quarter, and we still expect gross margin for the year to be between **50-51%**.

Q1 operating expenses were **42%** of revenue, up from **39**% in Q1 last year primarily due to higher sales & marketing and G&A cost reflecting the roughly **150** employees we added through our two acquisitions, continued R&D spending in support of our roadmap and the 2018 product launches and legal expenses associated with our ITC litigation.

We ended Q1 with **$184** million in cash, up from **$166** million at year-end. During the quarter, we established and announced a stock repurchase program authorizing the purchase of up to **$50** million of our common stock. The plan became effective on March 28th and to date we have repurchased approximately **260** thousand shares, through April 23, for roughly **$17** million. We expect to end the year with a cash balance of approximately **$150** million assuming we complete our **$50** million repurchase program during the year.

Q1 ending inventory was **$112** million or **101** days, as expected, compared with **$57** million or **64** days last year, driven by the acquisitions and the need to hold inventory for direct-to-retail sales in Japan and more than **50%** of EMEA. As we said last quarter, due to this structural change in our business model, we expect DII to be approximately **100** days **+/-** on average in 2018, with our typical quarterly fluctuations. As part of our integration efforts, we are working to identify operating efficiencies to improve working capital and reduce DII over time.

Now I'd like to provide you with additional detail and some of the underlying assumptions for our full-year 2018 financial expectations. As we have previously discussed, we manage our business from a full-year perspective. Likewise, our 2018 financial expectations should be viewed on a full-year basis as quarterly year-over-year revenue growth rates, and overall results, will vary greatly by region due to a number of factors including the impact of acquisitions we made in 2017.

For 2018 we continue to expect full year revenue of **$1.05** to **$1.08** billion with roughly **60%** of the year's revenue being delivered in the second half of the year. In addition to the traditional second-half seasonality of the business, 2018 will be positively impacted by the inclusion of revenue uplift from the European acquisition through the third quarter. Our revenue expectation range contemplates Yen and Euro exchange rates roughly in line with current rates, **+/- 5%**.

We continue to expect double digit year-over-year growth in each quarter and for revenue to increase sequentially throughout 2018 with the highest year-over-year growth rate in Q1 as we said last quarter. The smallest sequential quarterly increase is expected between the first and second quarters, and the largest sequential quarterly increase between Q3 and Q4. Profitability will be the lowest in Q2 driven by our sales & marketing expense increase over Q1, as is typical, to support the Q2 seasonal selling. In addition, Q3 sales & marketing, as a percent of revenue, is expected to decline from Q2 but not as significantly as in prior years due to our second half planned product launches.

For the full year, we continue to expect operating expenses to total roughly **42%** of revenue. Our full year guidance still assumes reinvesting the incremental gross margin provided by our forward integration primarily into higher sales & marketing spend. One-third of the incremental spending is a full year of expense associated with our two acquisitions and the remaining two-thirds for marketing expenses associated with our 2018 product launches and continued investments in the Roomba and Braava awareness campaigns to drive continued worldwide household adoption.

We continue to expect full-year operating income of **$86** to **$96** million and now expect EPS of **$2.15** to **$2.40,** reflecting a **$0.05** favorable impact, from stock compensation windfall, that we recorded in the first quarter.

In summary, we are executing against our plan with no major “new” news.

I’ll now turn the call back to Colin.

Colin

We are off to a very strong start in 2018 and I am very excited about the year ahead. We expect our global business to deliver strong financial performance in 2018 that will fund our ability to:

- Reinforce our core product leadership in the RVC category;
- Widen our competitive moat through technological differentiation protected by our IP portfolio; and,
- Extend our product portfolio.

We believe that consistent execution of this strategy is the most effective way to drive sustainable growth and shareholder value.

With that we’ll take your questions.

Following Q&A

Colin

That concludes our first quarter 2018 earnings call. We appreciate your support and look forward to talking with you again in July to discuss our Q2 results.

Operator: That concludes the call. Participants may now disconnect.